File

Canadian Merrill Ltd.

1976 ANNUAL REPORT

Canadian Merrill Ltd.

Incorporated Under the Laws of the Province of Quebec

DIRECTORS

ROBIN J. ABERCROMBIE,
Calgary, Alberta
Vice-President of The Alberta Gas Trunk Line Company Limited

KENNETH S. DALTON,
Toronto, Ontario
Vice-President, Finance of Hudson Bay Mining and Smelting Co., Limited

JEAN DEBRAY,
Toronto, Ontario
Vice-President, Petroleum of Hudson Bay Mining and Smelting Co., Limited

ADRIAN M. DOULL,
Toronto, Ontario
Senior Vice-President, Finance of Hudson Bay Mining and Smelting Co., Limited

V. LYLE HAWKES,
Edmonton, Alberta
President of L & M Oilfield Equipment (1975) Ltd.

HORACE REKUNYK,
Calgary, Alberta
Chairman of the Board and President of the Company

C. KEITH TAYLOR, Q.C.
Toronto, Ontario
Senior Vice-President, Secretary and General Counsel of Hudson Bay Mining and Smelting Co., Limited

JAMES M. THOMSON, Q.C.,
Calgary, Alberta
Associate in Milner & Steer

OFFICERS

HORACE REKUNYK,
Chairman of the Board and President

CHARLES W. TEMPLETON
Senior Vice-President, Exploration

ROBERT F. GILMOUR
Vice-President, Production and Engineering

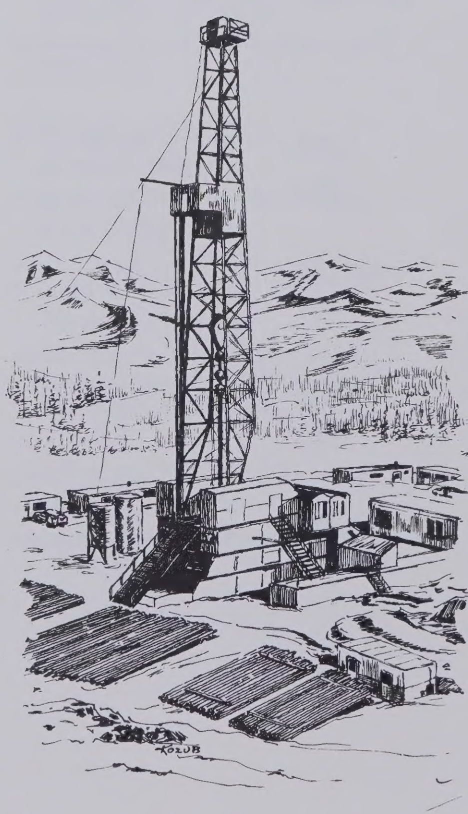
G. BARRY PADLEY, C.A.
Vice-President, Finance

WILLIAM C. MILLS
Secretary

Comparative Highlights

Financial	1976	1975	Increase Per Cent
Revenue by source:			
Oil and gas production	$10,382,000	$ 4,553,000	128.0
Interest and other income	170,000	103,000	65.0
Gross revenue	10,552,000	4,656,000	126.6
Cash flow from oil and gas operations	3,550,000	1,143,000	210.6
Per share	1.76	.57	
Income from continuing oil and gas operations	1,693,000	200,000	746.5
Per share	.84	.10	
Income (Loss) from discontinued operations	(296,000)	237,000	—
Net income for the year	1,987,000	495,000	301.4
Per share	.99	.25	
Capital expenditures	6,447,000	13,482,000	(52.2)
Working capital deficiency	(907,000)	(989,000)	—
Total assets	28,823,000	29,449,000	(2.1)
Shares outstanding	2,013,920	2,013,920	—
Operating			
Natural gas production, net before royalties:			
Total — million cubic feet	9,512	7,068	34.6
Daily average — million cubic feet	26.0	19.4	
Oil production, net before royalties:			
Total — barrels	224,831	181,245	24.0
Daily average — barrels	614	497	
Number of net productive wells:			
Gas	107.3	88.2	21.6
Oil	59.9	58.9	1.7
Acreage holdings:			
Gross	879,540	806,037	9.1
Net	438,566	362,713	20.9

Report to the Shareholders



The policy adopted by Canadian Merrill last year which directed its total resources into the expansion of its oil and gas interests has resulted in substantial increases in petroleum reserves, revenues and profits for the current year. This policy should result in continuing growth in future years.

Gross revenue from oil and gas operations increased 127% to $10,552,000 from $4,656,000 reflecting higher oil and gas production rates and price levels. Cash flow from continuing operations increased 211% to $3,550,000 ($1.76 per share) from $1,143,000 (57¢ per share). Net income at June 30, 1976, after extraordinary items, increased 301% to $1,987,000 (99¢ per share) from $495,000 (25¢ per share).

The sale of all of the well servicing and oilfield equipment assets for proceeds of approximately $7,300,000 has enabled the Company to reduce its long term debt and places it in a stronger financial position to expand its oil and gas interests.

Merrill's gas production during the past year increased 35% to 9,512 million cubic feet (an average of 26 million cubic feet per day) and oil production increased 24% to 224,831 barrels (an average of 614 barrels per day). These increases reflect a full year's production from the reserves purchased in January, 1975, and the placing of new gas reserves on production in the fourth quarter of fiscal 1976. Production has continued to increase to a current level of 33 million cubic feet of gas and 760 barrels of oil per day. It is expected that the Company's gas production will reach a level in excess of 40 million cubic feet per day by January, 1977. This level of production represents a minimum contract demand by the purchasers under the existing gas purchase contracts.

Merrill's gas production sold for an average price of 86.7¢ per thousand cubic feet (Mcf) in the current fiscal year compared with 41.7¢ per Mcf in the previous year. This improvement was the direct result of the increase in the wellhead price of gas to approximately 95¢ per Mcf effective November 1, 1975. Gas prices were subsequently increased to bring the average wellhead price to approximately $1.06 per Mcf on July 1, 1976. A further price increase is scheduled for January 1, 1977.

Merrill received an average price of $8.64 per barrel for its oil production during the past year. This average is higher than the maximum Canadian price of $8.00 per barrel as a result of the Company's United States production. On July 1, 1976 the price for Canadian crude increased by $1.05 to $9.05 per barrel. A further increase of 70¢ per barrel is scheduled for January 1, 1977.

The Company's drilling operations in the past year increased to 42 wells which resulted in 21 gas wells and one oil producer. Exploratory drilling by Merrill increased from 4 wells in 1975 to 15 wells in the current fiscal year. Most of the exploratory wells were drilled in the United States while all of the development wells were drilled in Alberta.

Two of the Company's areas of current activity are western Colorado and the Alberta foothills.

Merrill acquired a block of 26,900 acres with proven and potential gas reserves, including 6 gas wells, in the Rock Canyon area of western Colorado in March, 1976 for approximately $1,500,000. This acquisition was made in the belief that gas prices would improve in the United States as they had in Canada. This decision was confirmed by the Federal Power Commission's announcement that, effective July 27, 1976, the prices paid for interstate gas would be allowed to increase to $1.42 per Mcf from the previous ceiling of 52¢ per Mcf for gas dedicated after January 1, 1975 and $1.01 per Mcf for gas dedicated from January 1, 1973 to December 31, 1974. These increases resulted in effective prices to Merrill of $1.62 per Mcf and $1.78 per Mcf for its gas production from Rock Canyon after BTU adjustments and the 30% small producer's bonus where applicable. A multi-well drilling program underway on this property has resulted in 3 new gas wells being completed to date with 2 additional wells currently drilling.

In the Alberta Foothills, the Company is participating in the drilling of 3 deep exploratory wells. Two of these are being drilled under farmout from a group in which Merrill is a participant while the Company has a direct working interest in the third well. These test wells are all located on large acreage blocks totalling 157,000 acres.

The past year has seen further positive response from the Canadian Federal and Provincial Governments and the United States Government to the serious problems facing the oil and gas industry in financing, finding and developing new reserves. The Federal Governments in both countries have allowed increases in natural gas prices and in Canada oil prices have also been increased toward the average oil price in the United States. In addition, the Alberta Government diminished the adverse effects of the Canadian Federal tax regulations by allowing a royalty rebate to producers in the province. Alberta also passed legislation effective July 1, 1976, that should result in the more rapid turnover of exploratory Crown lands and assist independent producers such as Merrill, in obtaining drilling prospects.

The Company's exploration and development activities in Western Canada and the United States will increase in the coming year as the result of these developments and the availability of incentive credits offered in Canada. New exploratory prospects will be undertaken and all of the Company's current gas reserves under contract will be placed on production. This will entail additional development drilling and sizeable investments in new plant and pipeline facilities.

The Company continues to hold mining claims located in the Tache Lake and LaSarre areas in Quebec which have proven and indicated ore reserves and the milling facility located near Chibougamau, Quebec. Merrill will continue to evaluate these assets in light of current and future metal prices.

Hudson Bay Mining and Smelting Co., Limited has increased its common share equity interest in the Company from 29% to 44% of the outstanding shares through the acquisition of additional blocks of shares following the current fiscal year-end.

Mr. Jean Debray will not be standing for re-election as a Director of the Company due to other commitments. However, the Company is pleased to announce that Mr. John L. Carpenter, Executive Vice-President of Hudson Bay Mining and Smelting Co., Limited will be nominated to the Merrill Board of Directors.

It is with deep regret that we report the death of Mr. Randy P. Mills who had served as a Director of the Company from 1954 until January, 1976. Mr. Mills played an active role in the Canadian mining industry for over 40 years and was held in high regard by all who came in contact with him. His loss will be felt by all of his many associates.

Your Directors wish to acknowledge our employees' dedication and support during the past year.

Respectfully submitted on behalf of the Board of Directors.

H. ReKunyk
Chairman of the Board

September 27, 1976

Canadian Merrill Ltd.

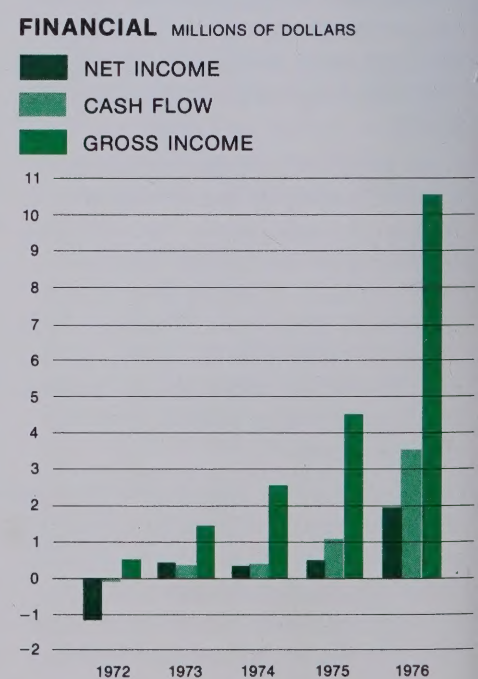
Operations

Production

Merrill and its subsidiaries held interests in 187 gross gas wells (107.3 net gas wells) and 244 gross oil wells (59.9 net oil wells) at year-end. The Company's producing properties are located primarily in the province of Alberta and the states of Colorado, Montana and Wyoming.

Merrill's gas production, before royalties, increased 35% in 1976 to 9,512 million cubic feet (26.0 million cubic feet per day) from 7,068 million cubic feet (19.4 million cubic feet per day) last year.

In Alberta, Merrill completed gas gathering and processing facilities in the Bolloque, Oyen, Wainwright and Edgerton fields during the year. These fields went on production during the latter part of the past



fiscal year so that the full effect of this production will not be felt until fiscal 1977. A significant increase in gas production from the Company's United States properties is anticipated following the drilling and development of its acreage in the Rock Canyon area, Colorado.

The Company's oil production before royalties increased 24% to 224,831 barrels (614 barrels per day) from 181,245 barrels (497 barrels per day) in 1975. This reflects a general increase in most of the Company's producing oil properties, particularly in the Peco and Princess areas, Alberta.

In the year ended June 30, 1976, the average gas price received by Merrill was 86.7¢ per thousand cubic feet (Mcf) compared with 41.7¢ in the previous year. Merrill's average oil price was $8.64 per barrel in the past year compared with $7.84 per barrel in 1975. These increases result from the price changes in Canada during the past year in which the wellhead price of natural gas increased to approximately 95¢ per Mcf on November 1, 1975 and the price of oil increased to $8.00 per barrel on July 1, 1975.

Effective July 1, 1976, the wellhead price of Canadian gas increased to approximately $1.06 per Mcf with a further increase scheduled for January 1, 1977. The price of oil increased on the same date by $1.05 to $9.05 per barrel with a further 70¢ per barrel increase scheduled for January 1, 1977.

In the United States, the price of natural gas was increased on July 27, 1976. In Merrill's operations at Rock Canyon, the new price will be approximately $1.62 per Mcf for gas committed prior to January 1, 1975. Gas committed after January 1, 1975 will be priced at approximately $1.78 per Mcf. Both prices include BTU adjustments and the first price also includes a 30% small producer's bonus.

Drilling and Development

Merrill's 1976 drilling program increased to 42 wells (20.7 net wells) from 38 (8.6 net wells) in the previous year. This program resulted in 21 gas wells, one oil well and 20 dry holes. Of the 15 exploratory wells drilled this year, 10 were located in the United States while all of the development wells were drilled in Alberta.

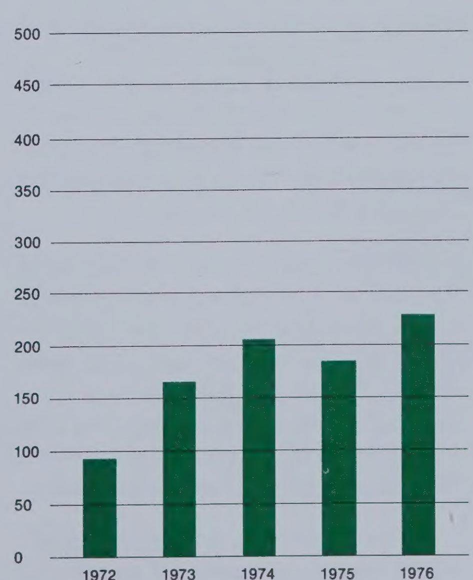
The Company will increase its drilling activities in the United States in the 1977 fiscal year and maintain its current level of drilling in Canada.

ALBERTA FOOTHILLS

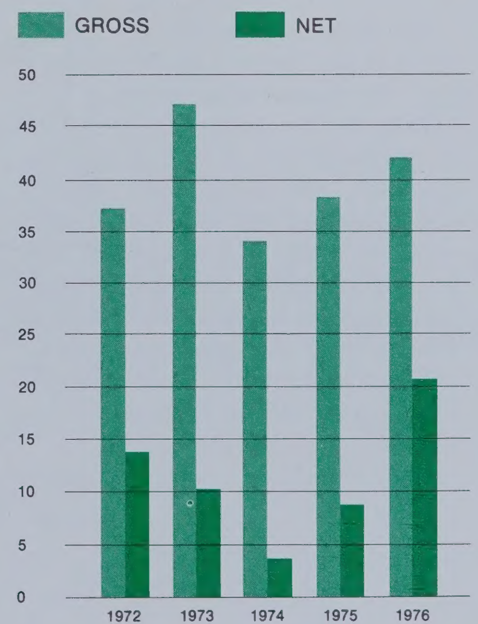
Canadian Merrill holds interests in partnership with Canadian Hunter Exploration (the operator), Algas Resources and SOQUIP in three acreage blocks along the Alberta foothills. Three deep exploratory wells are currently drilling on these prospects as summarized below.

GAS PRODUCTION
MILLIONS OF CUBIC FEET

OIL PRODUCTION
THOUSANDS OF BARRELS



WELLS DRILLED



Imperial Oil is drilling a 16,000-foot test well on 22,880 farmout acres in which Merrill holds a 20% working interest in the Brazeau area. On the completion of the well, Merrill will retain a 3% gross overriding royalty interest in the farmout acreage which is convertible to a 10% working interest. The well, Imp et al Muskiki 4-17-44-20, is currently drilling at 12,068 feet.

Also at Brazeau, Merrill holds a 20% working interest in an additional 22,880 acres, 5,760 acres of which have been pooled with an adjoining 5,760-acre block held by Chieftain Development et al and farmed out to Hudson's Bay Oil & Gas. The 13,500-foot Hudson's Bay test well, HB Home Blackstone 14-33-42-17, is currently drilling at 4,500 feet. Merrill will retain a 1.5% gross overriding royalty interest in the well spacing unit and a 5% working interest in the balance of the 11,520 acres of pooled acreage on the completion of this well. Hudson's Bay will also have an option to earn an interest in the balance of Merrill's acreage block by drilling thereon.

Merrill is participating for a 13% share in the 14,000-foot exploratory well, Canhunter et al Sherman 6-3-62-12. This well is drilling at 1,275 feet in the Sherman Flats area. The Company will earn a 5.5% working interest in the well and the 23,000 acres on which it is located on the completion of the well. Merrill also holds options to earn interests in an additional 77,000 acres and has a 13% working interest in an adjoining 11,520-acre drilling reservation.

ALBERTA PLAINS

The Company's major drilling activity in fiscal 1976 was centered in Alberta where it participated in 5 exploratory and 27 development wells.

Merrill purchased a 50% interest in an acreage block south of the Edwand field on which 5 shut-in gas wells are located. The Company participated in drilling an additional 3 wells on this property in 1976. Gas production from this area will be tied into the Company's Edwand gas plant later this year.

The Company drilled 3 successful gas wells in the Willingdon-Hairy Hill area. Merrill holds a 100% interest in 2 of these wells and a 30% interest in the third. All of these wells are scheduled to be placed on production during 1976.

The Company's producing area at Stanmore was extended during the past year by the completion of 2 additional gas wells in which Merrill holds a 90% interest. Development drilling in this area will continue during the coming year.

Merrill is currently engaged in a drilling program at Sunnynook to add to the gas well and 1,280 acres of lease it holds in this area. Following year-end, it has drilled 5 wells in the area resulting in 2 gas wells and 3 dry holes to earn working interests in 16,160 acres.

The Company holds a 9% working interest in a 7,360-acre lease block in the Medicine Hat-Schuler area on which 23 shallow gas wells had been drilled. Merrill participated in drilling another 7 gas wells on this property in 1976 and since year-end a further 17 gas wells have been completed.

In other Alberta drilling in fiscal 1976, Merrill completed 2 successful gas wells (90% and 12.5% interest) at Plain Lake and one each at Wainwright (63%) and Bolloque (65%). The Company also drilled one oil well (100%) in the Princess area.

BRITISH COLUMBIA

In British Columbia, the results of further testing of the indicated oil discovery well in the Fox area proved disappointing and the well was abandoned. No further drilling is planned for this property.

COLORADO

Canadian Merrill, through a wholly-owned United States subsidiary, purchased 26,900 acres of lease in the Rock Canyon area, Colorado for approximately $1,500,000 in March, 1976. This property includes 3 gas wells producing from the Mancos "B" formation, one gas well producing from the Dakota formation, one shut-in Mancos "B" gas well and one shut-in dual zone well completed in the Dakota and Cedar Mountain formations. Both Dakota gas wells also have potential Mancos "B" gas reserves available for future production.

The Company carried out remedial work on the 4 producing gas wells and increased the total daily production rate from 680,000 cubic feet to 1.1 million cubic feet. The dual-zone well has been placed on production at a rate of 400,000 cubic feet of gas per day. The other shut-in well will be tied into the gathering system this year.

A multi-well drilling program is now underway and all 3 wells drilled to date have been completed as gas wells. Two additional wells are currently drilling.

Reserves

As in past years, the following table summarizes proved and probable reserves before deducting royalties. These reserve totals are based on evaluations prepared by independent consulting engineers and Merrill's engineering staff. The independent appraisal firm of DeGolyer & MacNaughton, Dallas, Texas, estimated proved and probable reserves as of November 1, 1975. To arrive at the proved and probable remaining reserves as at June 30, 1976, adjustments were made to account for additional acquisitons, development and production since November 1, 1975.

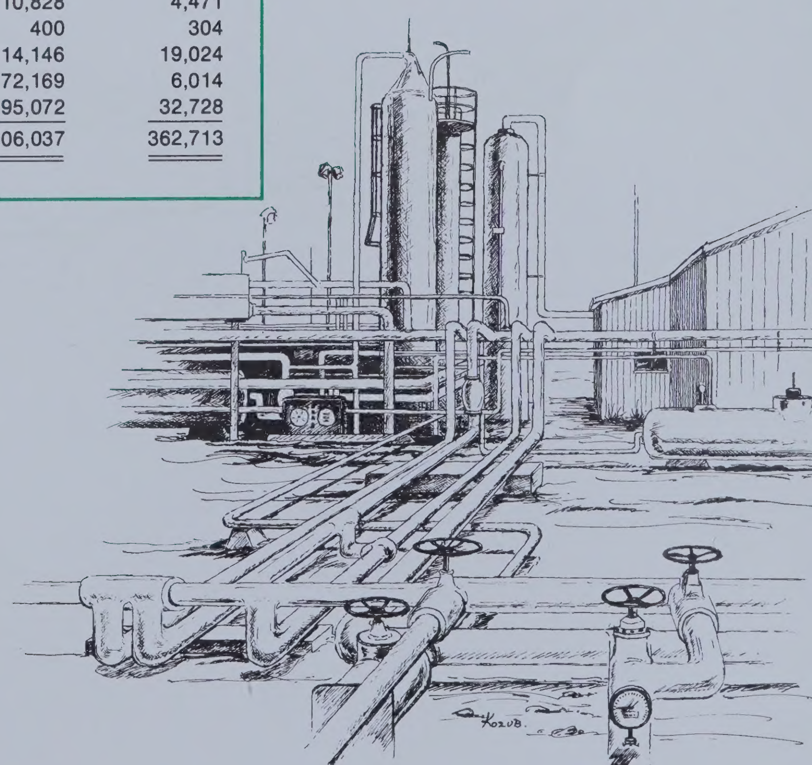
The comparative estimated reserves are as follows:

GROSS RESERVES	June 30, 1976	June 30, 1975
Natural Gas (billion cubic feet)	290	257
Crude Oil (barrels)	2,081,000	1,538,000

Acreage Holdings

At June 30, 1976, the Company and its wholly-owned subsidiaries held 879,540 gross acres, equivalent to 438,566 net acres as indicated in the accompanying comparative table.

ACREAGE	June 30, 1976		June 30, 1975	
	Gross	Net	Gross	Net
Alberta	570,008	349,937	513,422	300,172
British Columbia	10,810	4,540	10,828	4,471
Saskatchewan	240	144	400	304
Arctic Islands	114,146	19,024	114,146	19,024
East Coast — Offshore	72,169	6,014	72,169	6,014
United States	112,167	58,907	95,072	32,728
	879,540	438,566	806,037	362,713



Consolidated Statement of Operations
(in Canadian dollars)

	Year ended June 30 1976	1975 Restated (Notes 1 and 2)
Revenue:		
Oil and gas production revenue	$10,382,000	$ 4,553,000
Interest and other income	170,000	103,000
	10,552,000	4,656,000
Costs and expenses:		
Crown and overriding royalties	3,475,000	1,240,000
Production and operating	1,012,000	673,000
General and administrative	1,122,000	788,000
Interest on long term debt	1,133,000	552,000
Interest on income debenture	260,000	260,000
	7,002,000	3,513,000
Funds generated from continuing operations before current income taxes	3,550,000	1,143,000
Depletion and depreciation	1,195,000	782,000
Income from continuing operations before income taxes	2,355,000	361,000
Income taxes (Note 10):		
Current (Royalty rebate recoverable)	(709,000)	(256,000)
Deferred	1,371,000	417,000
	662,000	161,000
Income from continuing operations — oil and gas	1,693,000	200,000
(Loss) Income from discontinued operations (Note 2)	(296,000)	237,000
Income before extraordinary items (Note 1)	1,397,000	437,000
Reduction of income taxes (Note 10)	428,000	358,000
Gain on sale of investments	11,000	—
Provision for decline in value of investments	—	(300,000)
Gain on disposal of non-current assets related to discontinued operations (Note 2)	151,000	—
Net Income for the Year	$ 1,987,000	$ 495,000
Income per common share (Note 15):		
Before extraordinary items	$ 0.694	$ 0.217
Extraordinary items	0.293	0.029
Net Income for the Year	$ 0.987	$ 0.246

Consolidated Statement of Changes in Financial Position

(in Canadian dollars)

	Year ended June 30	
	1976	1975 Restated (Notes 1 and 2)
Working capital was provided by:		
Operations —		
Funds generated from (used in) operations before current income taxes:		
Continuing — oil and gas	$ 3,550,000	$ 1,143,000
Discontinued	(190,000)	983,000
	3,360,000	2,126,000
Current income taxes — discontinued	(104,000)	20,000
Royalty rebate recoverable — continuing	709,000	256,000
	3,965,000	2,402,000
Extraordinary items —		
Net proceeds on disposal of non-current assets related to discontinued operations	6,872,000	—
Proceeds on disposal of investments	173,000	—
	11,010,000	2,402,000
New long term debt	1,531,000	10,076,000
Peru exploration expenditures recovered	—	1,047,000
Sale of properties and equipment	91,000	1,255,000
Decrease in advances to drilling fund programs	178,000	852,000
Interest free gas prepayments	329,000	—
Other	—	79,000
	13,139,000	15,711,000
Working capital was used for:		
Additions to properties and equipment — continuing operations	6,277,000	12,406,000
Additions to properties and equipment — discontinued operations	170,000	1,076,000
Reduction of long term debt	5,451,000	2,803,000
Peru exploration expenditures	—	1,075,000
Decrease in deferred oil and gas revenue	—	170,000
Notes and mortgages receivable	941,000	—
Advances (repayments) to affiliated companies	(5,000)	76,000
Special taxes paid on surplus of subsidiaries	149,000	—
Acquisition of shares of affiliates and subsidiaries	20,000	223,000
Other	54,000	5,000
	13,057,000	17,834,000
Increase (decrease) in working capital for the year (Note 3)	82,000	(2,123,000)
(Deficiency) working capital, beginning of year	(989,000)	1,134,000
(Deficiency) of working capital, end of year	$ (907,000)	$ (989,000)

Canadian Merrill Ltd. (Governed by the Quebec Companies Act)

Consolidated Balance Sheet

(in Canadian dollars)

	June 30 1976	June 30 1975 Restated (Notes 1 and 2)
assets		
Current assets:		
Accounts receivable (Note 4)	$ 2,232,000	$ 3,000,000
Royalty rebate recoverable (Note 10)	724,000	252,000
Note and mortgage payments due within one year	433,000	—
Inventories (Note 2)	—	359,000
Prepaid expenses and deposits	33,000	115,000
	3,422,000	3,726,000
Investments (Note 6):		
Notes and mortgages receivable	941,000	—
Companies for which there is a quoted market value	143,000	304,000
Affiliated companies	—	53,000
	1,084,000	357,000
Properties and equipment, at cost (Note 7)	26,564,000	28,422,000
Less: Accumulated depletion and depreciation	2,819,000	4,724,000
	23,745,000	23,698,000
Unamortized costs — discontinued mining and milling operations (Note 2)	572,000	680,000
Goodwill (Note 2)	—	988,000
	$28,823,000	$29,449,000

APPROVED BY THE BOARD:

H. REKUNYK, Director.

J.M. THOMSON, Q.C., Director.

	June 30	
	1976	1975 Restated (Notes 1 and 2)
liabilities		
Current liabilities:		
Bank demand loans and indebtedness (Note 8)	$ 275,000	$ 611,000
Accounts payable and accrued	2,143,000	1,962,000
Current portion of long term debt	1,911,000	2,142,000
	4,329,000	4,715,000
Long term debt (Note 9)	11,445,000	14,847,000
Deferred income taxes (Note 10)	3,436,000	2,088,000
Minority interests	—	24,000
shareholders' equity		
Capital stock (Note 11):		
Authorized —		
2,000,000 preferred shares of $5 par value		
10,000,000 common shares of no par value		
Issued —		
2,013,920 common shares	6,692,000	6,692,000
Retained earnings (Note 12)	2,921,000	1,083,000
	9,613,000	7,775,000
Contingent liabilities and commitments (Note 13)		
	$28,823,000	$29,449,000

Notes to Consolidated Financial Statements
at June 30, 1976 and June 30, 1975

1. **Summary of significant accounting policies:**
(Reference should be made to Note 2 which refers to operations discontinued during fiscal 1976.)

Principles of consolidation —
The consolidated financial statements include the accounts of Canadian Merrill Ltd. and its subsidiaries, all of which are wholly-owned as of June 30, 1976.

The equity method of accounting for investments in affiliated companies (20% to 50% owned) is followed.

In the case of acquisitions accounted for as purchases, the cost of investment in such subsidiaries in excess of the estimated value of the underlying net tangible assets at dates of acquisition, "Goodwill", is being amortized by charges against operations over a twenty-year period on a straight-line basis.

Inventories —
Inventories for resale are valued at the lower of average cost or net realizable value.

Oil and gas drilling fund programs —
Pursuant to the authority granted to it as manager of oil and gas drilling programs, a subsidiary company, Provident Resources Ltd., ("Provident") finances continuing programs' activities by term production bank loans, secured by assignments of title to certain program properties. Advances to programs are considered to be eliminated on allocation of such loans as outlined in Note 5.

Investment in companies for which there is a quoted market value —
These investments are carried at the lower of cost or estimated ultimate realizable value.

Properties and equipment — depletion, depreciation and amortization —

Oil and gas properties and equipment —
The companies follow the full cost method of accounting for petroleum and natural gas properties whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include acquisition costs, geological costs, exploration overhead, carrying charges of non-producing properties and costs of drilling both productive and non-productive wells. Production equipment and gas facilities are recorded at cost. Depletion and depreciation are provided for by the unit of production method based on total estimated proven reserves of oil and gas. No gains or losses are recognized upon the sale or disposition of properties

except under circumstances which result in major disposals of reserves.

Buildings, service rig equipment and rental equipment —
These costs are depreciated over the estimated useful lives of such assets using the straight-line method, except for other equipment which is depreciated by the declining balance method.

Additions, improvements and repairs and maintenance that significantly add to productive capacity or extend the life of an asset are capitalized. Other expenditures for repairs and maintenance are charged to income as incurred.

Depreciation rates are as follows —

	Rate per annum
Buildings	3 -12 1/2%
Service rig equipment	6 2/3%
Rental equipment	6 2/3 -20%
Other equipment including automobiles, furniture and fixtures	20 -30%

Discontinued mining and milling operations —
Mining — mill buildings and equipment are carried at their unamortized cost which is estimated to be not greater than realizable value. Production from the related copper ore body ceased in June, 1975. The undepreciated cost of these assets, together with the cost of mill supplies, (primarily replacement parts), are being amortized over the remaining life of the lease with respect to the land upon which these assets are situated.

With the exception of exploration costs related to the Perch River, Quebec mining claims, all such costs have been written off. While work to date has not established a proven ore reserve, the Company intends to continue to hold the Perch River claims. Commencing in fiscal 1976, these costs are being amortized.

The remaining period of amortization (approximately six years at June 30, 1976) for both mining-mill buildings and equipment and the Perch River exploration costs represents the anticipated maximum holding period during which sale and/or exploration possibilities will be considered.

Income taxes —
The companies follow tax allocation accounting whereby deferred income taxes are provided to the extent that current income taxes have been reduced as a result of claiming deductions for capital cost allowances and drilling, exploration and lease acquisition costs in excess of the related charges in the accounts.

Income per common share —
Income per common share has been calculated in accordance with Canadian practice.

Extraordinary items —
The companies follow Canadian practice with respect to the definition of extraordinary items. The extraordinary items, shown in the consolidated statement of operations (except for the income tax reduction) would be considered ordinary items under United States practice; income per common share before extraordinary items would be increased accordingly but net income would remain unchanged.

Comparative figures —
Accounts for fiscal 1975 have been restated to conform with the fiscal 1976 presentation.

2. Discontinued operations:

During fiscal 1976, the Company disposed of its well servicing and equipment rentals and sales divisions. The rentals and sales division assets were sold to a director. Certain of the well servicing division assets were sold to former employees. Copper milling operations ceased in early fiscal 1976 and mining exploration operations were suspended. Results of operations of these divisions are included in the account, "(Loss) income from discontinued operations" which consists of the following:

	1976	1975
Well servicing and equipment rentals and sales:		
Revenue	$2,622,000	$7,176,000
(Loss) net income for period/year	$ (49,000)	$ 428,000
Income taxes	6,000	241,000
(Loss) net income for period year	$ (55,000)	$ 187,000
Milling - mining:		
Milling revenue (adjustments)	$ (37,000)	$ 183,000
(Loss) income before income taxes (i)	$ (349,000)	$ 124,000
Reduction of (provision for) deferred income taxes	108,000	(74,000)
(Loss) net income for period/year	$ (241,000)	$ 50,000
Combined (loss) net income for period/year	$ (296,000)	$ 237,000

(i) includes write off of $39,000 pertaining to a Quebec sales tax reassessment, previously considered recoverable.

The account, "Gain on disposal of non-current assets related to discontinued operations" consists of the following:

Gain on sale of properties and equipment of the well servicing and equipment rentals and sales divisions	$2,017,000
Loss on sale of shares of a subsidiary engaged in the well servicing business	60,000
Other, net, primarily employee termination costs	210,000
	1,747,000
Deferred income taxes	625,000
	1,122,000
Write off of unamortized balance of related Goodwill	971,000
	$ 151,000

The account, "Unamortized costs — discontinued mining and milling operations" consists of the following:

	1976	1975
Mining-mill buildings and equipment, at cost	$1,418,000	$1,440,000
Accumulated depreciation and amortization	1,153,000	1,116,000
	265,000	324,000
Deferred costs related to mining claims, net of accumulated amortization of $51,000 (1975 — NIL)	307,000	356,000
	$ 572,000	$ 680,000

The fiscal 1975 accounts have been restated to reflect, separately, the results of discontinued operations and, as indicated above, the unamortized costs of discontinued mining and milling operations. Assets related to the discontinued well servicing and equipment rentals and sales divisions which were sold have not been segregated in the fiscal 1975 accounts. Balances of such assets, at June 30, 1975, are summarized below:

Inventories — new and used oilfield equipment	$ 359,000
Properties and equipment, less accumulated depreciation	$5,028,000
Goodwill, less amortization	$ 988,000

3. Changes in components of working capital:

	1976	1975
Increase (decrease) in current assets —		
Cash and deposit receipts	$ —	$(1,574,000)
Accounts receivable	(768,000)	267,000
Note and mortgage payments due within one year	433,000	—
Royalty rebate recoverable	472,000	252,000
Inventories	(359,000)	(51,000)
Other	(82,000)	47,000
	(304,000)	(1,059,000)
Less: Decrease (increase) in current liabilities —		
Bank demand loans and indebtedness	336,000	(334,000)
Accounts payable and accrued	(181,000)	215,000
Current portion of long term debt	231,000	(945,000)
	386,000	(1,064,000)
Increase (decrease) in working capital	$ 82,000	$(2,123,000)

4. Accounts receivable:

	1976	1975
Trade	$2,209,000	$ 2,940,000
Quebec sales tax reassessment under appeal (Note 2)	23,000	52,000
Due from an officer	—	7,000
Due from a company, controlled by a director and officer (i) (ii)	—	1,000
	$2,232,000	$ 3,000,000

(i) This account had an average receivable balance of $55,000 during fiscal 1975 and an average $51,000 payable balance during fiscal 1974.

(ii) Subsequent to June 30, 1975, this account balance increased by $140,000; the resulting balance was repaid in full on October 3, 1975.

5. Interest bearing advances — drilling fund programs:

As outlined in Note 1, advances to drilling fund programs are considered to be eliminated on allocation of term production bank loans so obtained.

	1976	1975
Amounts charged to drilling fund programs	$221,000	$399,000
Term production loans allocated — June 30	221,000	399,000
Advances to drilling fund programs	$ —	$ —

During fiscal 1975, the Company invited the drilling fund program participants to offer to sell their petroleum and natural gas interests to the Company. Offers totalling approximately $7,500,000 were accepted by the Company.

6. Investments:

(a) Market value of investments in companies for which there is a quoted market value was $119,000 as at June 30, 1976 ($392,000 — 1975).

(b) Investments in affiliated companies —

	1976	1975
Shares, at cost plus equity in undistributed net income since acquisition	$ —	7,000
Deferred gain on sale of equipment	—	(10,000)
Interest bearing advances	—	56,000
	$ —	$ 53,000

At June 30, 1974, there were three 50% owned affiliated companies engaged in the well servicing business. During fiscal 1975 and 1976 the balance of the outstanding share capital of these companies was acquired. The acquisitions were accounted for as

purchases. The Company's share of net income to dates of acquisition was accounted for by the equity method; subsequent to acquisition, results were consolidated.

On a pro-forma basis, results of operations would not be materially different if it were assumed that the acquisitions had taken place at July 1, 1975. As outlined in Note 2 all well servicing operations were discontinued during fiscal 1976.

7. Properties and equipment:

	1976	1975
Cost:		
Continuing operations — oil and gas —		
Petroleum and natural gas properties	$26,248,000	$20,033,000
Other	316,000	271,000
	$26,564,000	$20,304,000
Discontinued operations — well servicing and equipment rentals and sales —		
Land and buildings	$ —	$ 611,000
Service rig equipment	—	5,613,000
Rental equipment	—	1,128,000
Other	—	766,000
	$ —	$ 8,118,000
	$26,564,000	$28,422,000
Accumulated depletion and depreciation —		
Continuing operations — oil and gas:		
Petroleum and natural gas properties	$ 2,672,000	$ 1,532,000
Other	147,000	102,000
	$ 2,819,000	$ 1,634,000
Discontinued operations — well servicing and equipment rentals and sales —		
Buildings	$ —	$ 175,000
Service rig equipment	—	2,339,000
Rental equipment	—	216,000
Other	—	360,000
	$ —	$ 3,090,000
	$ 2,819,000	$ 4,724,000

8. Bank loans and indebtedness:

Bank loans and indebtedness are secured by a general assignment of accounts receivable, a floating charge debenture covering the assets of Provident and an assignment of interests (as well as the interests of the drilling fund programs) in petroleum and natural gas properties, together with specific assignments of production therefrom. Interest on demand loans is presently ½ of 1% over the Canadian prime rate.

9. Long term debt:

	1976	1975
Secured convertible income debenture, payable to a 29% shareholder, interest at 6½%, due October 31, 1989, repayable in annual instalments of $400,000 commencing on October 31, 1980; convertible into common shares at $6 per share to February 28, 1979 and $7 per share thereafter to February 28, 1984; secured by a first floating charge on all of the property and assets of the Company subject to specific permitted encumbrances and a pledge of the shares of Provident; includes restrictions as to acquisition and disposition of assets, indebtedness, amalgamation, authorization and issuance of share capital	$ 4,000,000	$ 4,000,000
Term production bank loans, interest at ½ to ¾ of 1% over the Canadian prime rate, evidenced by demand notes, secured as outlined in Note 8, repayable monthly, to mature 1978-1982	8,940,000	12,788,000
Interest free gas prepayments, due monthly to 1981	416,000	—
Other loans, notes payable and mortgages	—	201,000
	13,356,000	16,989,000
Less: Current portion of long term debt	1,911,000	2,142,000
	$11,445,000	$14,847,000

Principal repayments over the next five fiscal years are as follows:

1977	$1,911,000
1978	$1,911,000
1979	$1,686,000
1980	$1,666,000
1981	$2,047,000

10. Income taxes:

The Company and each of its subsidiaries are required to file separate tax returns. Prior to fiscal 1975, provisions for current and deferred income taxes, recorded in the consolidated financial statements, related solely to the subsidiary companies. No provision for income taxes was required in the accounts of Canadian Merrill Ltd. (as a corporation) since its operations, to June 30, 1974, resulted in accounting losses. On a cumulative basis to June 30, 1974, its costs and expenses charged to operations exceeded the corresponding amounts deducted for tax pur-

poses by approximately $3,900,000. Since the realization of the related possible future tax benefits was not virtually assured, they have not been recorded in the accounts. Fiscal 1975 and 1976 operations of Canadian Merrill Ltd. (as a corporation) resulted in accounting income. The fiscal 1975 and 1976 consolidated provision for deferred income taxes includes the taxes (based on a historical rate of 35%) which would have been payable on this accounting income had these taxes not been reduced (eliminated) by deducting previously unclaimed costs in excess of the related amounts charged to operations in fiscal 1975 and 1976. These reductions in taxes otherwise payable have been shown as extraordinary items. As a result of the foregoing, the excess of approximately $3,900,000 has been reduced to approximately $1,650,000 at June 30, 1976 and the related unrecorded possible future tax benefits have been reduced to approximately $570,000 based on a historical tax rate of 35%. No provision has been made for possible future tax benefits which may arise as a result of carrying forward capital losses arising from the writedown and loss on disposal of invesments.

During fiscal 1975 and 1976, several amendments were made to the Canadian Income Tax Act that will significantly increase the income taxes of the resource industries. The main amendments resulted in royalties and similar payments to governments no longer being deductible and in limitations being imposed on the deduction of certain development expenses and depletion allowances; rates of income tax applicable to resource production profits were reduced. Responding to the actions of the Canadian Government, some provinces have enacted legislation providing for certain rebates in order to provide some measure of relief to resource companies.

The consolidated provisions for income taxes are comprised of the following:

	Current	Deferred
Fiscal 1976:		
Continuing operations — oil and gas —		
Canadian Merrill Ltd. — based on a historical rate of 35%	$ —	$ 536,000
Provident Resources Ltd. and its wholly owned subsidiary, at current rates	—	1,021,000
Estimated royalty rebates recoverable	(709,000)	(186,000)
	$ (709,000)	$ 1,371,000
Discontinued operations — well servicing and equipment rentals and sales and mining-milling —		
Canadian Merrill Ltd. — based on a historical rate of 35%	$ —	$ (108,000)
Subsidiaries — at current rates	104,000	(98,000)
	$ 104,000	$ (206,000)
Taxes applicable to gain on disposal of non-current assets related to discontinued operations	$ —	$ 625,000
Fiscal 1975:		
Continuing operations — oil and gas —		
Canadian Merrill Ltd. — based on a historical rate of 35%	$ —	$ 314,000
Provident Resources Ltd. and its wholly owned subsidiary, at current rates	—	184,000
Estimated royalty rebates recoverable	(256,000)	(81,000)
	$(256,000)	$ 417,000
Discontinued operations — well servicing and equipment rentals and sales and mining-milling —		
Canadian Merrill Ltd. — based on a historical rate of 35%	$ —	$ 74,000
Subsidiaries, at current rates	(20,000)	261,000
	$ (20,000)	$ 335,000

Royalties and similar payments to provincial governments, interest on the secured income debenture, goodwill amortization and write-off and certain other charges, that are not deductible for tax purposes, result in increased tax provisions. Capital gains are either not taxed or taxed at a reduced rate.

11. Capital stock:

Of the authorized but unissued common shares, 791,167 were reserved at June 30, 1976 for the following:

Secured convertible income debenture (Note 9)	666,667
Employees and officers — under the Incentive Stock Option Plan, options to purchase 74,150 shares (at prices from $5.00 to $5.85) are exercisable cumulatively in five equal annual instalments up to May, 1979	124,500
	791,167

Subsequent to June 30, 1976, employee options covering 57,500 shares were exercised at a price of $5.00 per share.

12. Consolidated retained earnings:

	1976	1975
Balance, beginning of year	$1,083,000	$ 588,000
Net income for the year	1,987,000	495,000
Special taxes paid on surplus of subsidiaries	(149,000)	—
Balance, end of year	$2,921,000	$1,083,000

13. Contingent liabilities and commitments:

The companies have commitments in the normal course of business, including Provident's agreements to manage the drilling fund programs.

To the extent that bank loans referred to in Note 5 are not repaid from the proceeds of production from, or sale of, program properties, Provident would be directly liable.

14. Remuneration of directors and officers:

The Company has eight directors who received fees of $14,600 ($10,600 — 1975) and seven officers, three of whom were also directors, who received remuneration of $243,476 ($285,132 — 1975 to eight officers, five of whom were also directors) in their capacity as officers.

15. Income per common share:

Basic income per common share is based on the weighted average number of common shares outstanding (2,013,920 shares) during each fiscal year.

Fully diluted income per common share is based on the assumption that the shares reserved for future issuance under the terms of the secured convertible income debenture (666,667 shares) and the shares (74,150 shares) with respect to which options are granted under the Incentive Stock Option Plan had been issued at the beginning of each fiscal period. Income has been increased by the interest on the income debenture and earnings at 5% have been imputed based on the assumed after-tax interest which could have been earned on the funds received from the exercise of the options.

	Basic Income (loss) per Common Share	Fully Diluted Income (loss) per Common Share
Fiscal 1976:		
Income from continuing operations — oil and gas	$0.841	$0.716
(Loss) from discontinued operations — well servicing, equipment rentals and sales and mining-milling	(0.147)	(0.107)
Income before extraordinary items	0.694	0.609
Extraordinary items	0.293	0.214
Net income for the year	$0.987	$0.823

	Basic Income pe Common Share
Fiscal 1975:	
Income from continuing operations — oil and gas	$0.099
Income from discontinued operations — well servicing, equipment rentals and sales and mining-milling	0.118
Income before extraordinary items	0.217
Extraordinary items	0.029
Net income for the year	$0.246

Under United States practice primary and fully diluted earnings per share would not differ materially, except that extraordinary items (except for the income tax reduction) would not be considered extraordinary items.

16. Anti-inflation legislation:

The companies are subject to controls instituted by the Canadian Government in the Anti-inflation Act, effective October 14, 1975, on prices and profits related to certain discontinued operations and on compensation and dividends with respect to continuing operations. In the opinion of management, the companies have, in all material respects, complied with the guidelines since their announcement.

Auditors' Report

Price Waterhouse & Co.
CHARTERED ACCOUNTANTS

25th Floor, One Palliser Square
Calgary, Alta. T2G 0P6
(403) 263-3310 Telex 038-24748

To the Shareholders of
Canadian Merrill Ltd.

We have examined the consolidated balance sheets of Canadian Merrill Ltd. and its subsidiaries as at June 30, 1976 and 1975, and consolidated statements of operations and changes in financial position for the years then ended, and have obtained all the information and explanations we have required. Our examinations included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion and according to the best of our information and the explanations given to us and as shown by the books of the companies, these consolidated financial statements are properly drawn up so as to exhibit a true and correct view of the state of the affairs of the companies as at June 30, 1976 and 1975, and the results of their operations and the changes in their financial positions for the years then ended, in accordance with generally accepted accounting principles consistently applied.

Calgary, Canada
September 15, 1976

PRICE WATERHOUSE & CO.,
Chartered Accountants

Management's Discussion and Analysis of The Summary of Operations

FISCAL 1976 COMPARED TO FISCAL 1975

Revenue, and as a result, net income from oil and gas operations increased significantly as the result of (a) higher production of natural gas (up 34.6%) due to the effect of a full year of production from the properties purchased from former participants of Provident sponsored drilling fund programs effective January 1, 1975 and further new reserves put into production in early 1976, (b) higher average wellhead prices for natural gas, 86.7¢ for fiscal 1976 versus 41.7¢ for fiscal 1975, and (c) higher crude oil production and average wellhead prices received. Crown and overriding royalties also increased as a percentage of total oil and gas production revenue to 33.5% from 27% for the previous year reflecting the higher provincial crown royalty scale applicable to higher natural gas prices. Interest costs are double the fiscal 1975 experience reflecting higher average levels of indebtedness throughout 1976 as compared to 1975 as a result of the purchase of producing properties in early 1975, and higher rates of interest.

FISCAL 1975 COMPARED TO FISCAL 1974

Revenue from oil and gas operations increased significantly as the result of (a) higher production of natural gas (up 29%), primarily from the purchase of producing properties from former participants of Provident sponsored drilling fund programs effective January 1, 1975 and new reserves put on production in January, 1975, (b) higher average wellhead prices for natural gas, and (c) higher average wellhead prices for crude oil despite a decline in actual production. However, offsetting these revenue gains were more significant increases in Government royalties, averaging over 27% of gross revenues for 1975 versus approximately 19% for 1974.

Interest costs on bank borrowings were higher as the result of the purchase of proven reserves in early 1975. Interest costs applicable to the 6½% income debenture, which are not deductible for income tax purposes, are included in the fiscal 1975 results for a full year versus a four month period applicable to fiscal 1974.

FISCAL 1974 COMPARED TO FISCAL 1973

Revenue from oil and gas operations increased as the result of the combination of higher production for both natural gas and oil together with higher average prices received at the wellhead.

STOCK PRICE

The following table indicates the quarterly high bid and low bid prices for the common stock of the Company on the Toronto Stock Exchange for the last two fiscal years of the Company.

	Fiscal 1976		Fiscal 1975	
First Quarter	$ 6.00	$ 4.40	$3.20	$2.00
Second Quarter	6.00	4.65	3.05	1.60
Third Quarter	6.75	5.25	3.80	1.80
Fourth Quarter	10.62	6.00	4.60	2.75

Canadian Merrill Ltd.

Five Year Financial Review

(Thousands of dollars, except per share amounts)

	Year Ended June 30				
	1976	1975	1974	1973	1972
Revenues:					
Oil and gas production revenue	$10,382	$4,553	$2,486	$1,474	$ 549
Interest and other income	170	103	115	18	—
	10,552	4,656	2,601	1,492	549
Costs and Expenses:					
Crown and overriding royalties	3,475	1,240	480	191	68
Production and operating	1,012	673	456	324	139
General and administrative	1,122	788	616	301	142
Interest on long term debt	1,133	552	464	266	131
Interest on income debenture	260	260	87	—	—
Costs incurred re acquisition of Provident	—	—	—	—	83
	7,002	3,513	2,103	1,082	563
Funds Generated from Continuing Operations, before current income taxes	3,550	1,143	498	410	(14)
Per common share	$ 1.76	$ 0.57	$ 0.25	$ 0.20	$ —
Depletion and depreciation	1,195	782	426	293	107
Income before income taxes	2,355	361	72	117	(121)
Income Taxes					
Current (Royalty rebate recoverable)	(709)	(256)	—	—	—
Deferred	1,371	417	74	99	5
	662	161	74	99	5
Income (Loss) From Continuing Operations — oil and gas	1,693	200	(2)	18	(126)
(Loss) Income from Discontinued Operations	(296)	237	652	453	(449)
Income (Loss) Before Extraordinary Items	1,397	437	650	471	(575)
Per common share	$ 0.69	$ 0.22	$ 0.32	$ 0.24	$ (0.34)
Provision for decline in value of marketable securities	—	(300)	(300)	—	(670)
Gain (loss) on sale of shares	11	—	38	(28)	—
Gain on sale of drilling rig	—	—	—	59	—
Reduction of income taxes	428	358	—	—	—
Gain on disposal of non-current assets related to discontinued operations	151	—	—	—	—
Net Income (Loss) for the Year	$ 1,987	$ 495	$ 388	$ 502	$(1,245)
Per Common Share	$ 0.99	$ 0.25	$ 0.19	$ 0.25	$ (0.74)

Canadian Merrill Ltd.

Executive Office
Suite 2900, Scotia Centre
700 - 2nd Street S.W.
Calgary, Alberta T2P 2W2*

Head Office
1203 IBM Building
5 Place Ville Marie
Montreal, Quebec H3B 2H1

Stock Exchange Listings
TORONTO STOCK EXCHANGE
Toronto, Ontario
MONTREAL STOCK EXCHANGE
Montreal, Quebec
AMERICAN STOCK EXCHANGE
New York, New York

Auditors
PRICE WATERHOUSE & CO.
Chartered Accountants,
Calgary, Alberta

Principal Operating Subsidiaries
PROVIDENT RESOURCES LTD.
PROVIDENT RESOURCES, INC.

Transfer Agents & Registrar
THE CANADA PERMANENT TRUST COMPANY,
Montreal, Quebec
Toronto, Ontario
Calgary, Alberta
THE CANADIAN BANK OF COMMERCE
TRUST COMPANY
New York, New York

Bankers
THE ROYAL BANK OF CANADA
Calgary, Alberta

* Please note that effective November 1, 1976 the address of the Company's Executive Office is as noted above. All inquiries from shareholders should be sent to this address. Prior to November 1, 1976, the Executive Office address is 630 IBM Building, Calgary, Alberta T2P 1T1.

lawson graphics weste
Litho'd in Canada